Global Equity Views
Themes and implications from the Global Equity Investors Quarterly

In brief

• Since the scare of the regional banking crisis in March, economic growth has held up well, and so have corporate profits. Widespread forecasts of imminent U.S. recession have so far been off the mark.

• Meanwhile, equity markets have made strong progress, inspired by dreams of the artificial intelligence (AI) transformation, which has concentrated gains in a few proven mega cap technology winners.

• Our equity investors are only modestly positive on markets, with very few predicting outsized returns from this starting point. But most think overall returns will be average rather than poor.

• Once again, we prefer quality stocks across a wide range of sectors, but the most obviously defensive stocks look overpriced. We remain very skeptical of many companies that still boast sizable market capitalizations but have yet to record a profit. Despite high valuations, we think it is too early to take a stance against the AI winners.

Taking stock

At the time of our last quarterly, equity markets were gripped by a crisis of confidence in U.S. regional banks, which were struggling to retain deposits as interest rates moved rapidly higher. Following a couple of spectacular and rapid failures, the sector seems to have stabilized; Credit Suisse has so far been a unique case in an otherwise robust European banking industry.

The mini banking crisis has yet to spill over into the real economy, which continues to expand, defying almost universal forecasts of recession. Corporate profits have held up well, too. Although we still expect profits to slip a little this year, consumer demand is healthy, most companies continue to command pricing power, input costs have moderated, and the additional benefits of stimulus spending will start to kick in later in 2023.

One disappointment is China, where we have reduced our near-term profit numbers to reflect only a modest rebound following the relaxation of COVID-19 restrictions, with a weak real estate market a continued drag on economic activity.

Despite a slight drop in earnings this year, equity markets have posted strong gains driven by rerating, and the S&P 500 index now trades at a lofty 19x forward earnings. Nowhere has the rerating been more pronounced than in the resurgent technology sector. Previously popular value-based styles have lagged this year, and investors have shown remarkably little
The recent increase in index concentration is a U.S.-specific phenomenon; concentration across developed markets has remained broadly the same over the last decade.

**Exhibit 1: Index concentration (Herfindahl-Hirschman Index)**


The Herfindahl Hirschman Index (HHI) is a measure of industry concentration and an indicator of the amount of competition between firms. It is calculated by squaring the market share of each firm competing in the market and then summing the resulting numbers. In the case of the equity index, HHI is calculated using index weights instead of market share.

Interest in dividend-paying stocks. As a result, the gap between the valuations of high and low priced stocks has widened again to levels above the 90th percentile of the last 30 years, yet it is still short of the peak in late 2021. Returns have been highly concentrated — it’s the narrowest market of the last 30 years (Exhibit 1), although this is much less evident outside the technology-dominated U.S. market.

Despite the enthusiasm for AI, the price demanded for the fastest-growing companies still falls below the 2021 peak. Meanwhile, investors aggressively discount the lowest priced, slowest-growing names (Exhibit 2).

These stocks are concentrated in sectors that have long struggled to grow, such as airlines, traditional automobile manufacturers and real estate. They’ve been very tough industries to find winning stocks in for many years now. Debt levels are high for many of these companies, too, another reason many of our investors have dismissed the low prices and lengthy underperformance. Across international markets, Chinese stocks look cheap again despite lower profit forecasts, and value stocks in Europe look attractive as well.

**Exhibit 2: Relative valuation of high growth and low growth cohorts**

Source: J.P. Morgan Asset Management, Factset; data as of June 2023. Chart shows the relative PEy6 for the high and low Trend Growth cohorts.
Research views: U.S. profits remain resilient, with margins at very high levels

Despite the expectations of a weaker macroeconomic backdrop, our U.S. earnings estimates have actually risen slightly this year. But with the S&P 500 trading at 16x our normalized earnings forecast—a 15% premium to history—profits need to grow to support stock prices. The big debate is around margins, which are very high vs. history but look sustainable to our research team.

Our research themes include industrials, which may benefit from upcoming stimulus spending; recently out-of-favor financials; and energy stocks. We continue to avoid the “never profitable” stocks that were in fashion until last year. We also find the shares of companies with the most recession-proof businesses relatively unattractive; worries over economic growth have driven up their valuations to elevated levels, and expected returns are toward the low end of our rankings.

What to make of the AI transformation?

No matter how you measure it, AI has been the dominant theme in markets so far in 2023. Following the incredible progress of the ChatGPT app (which reached 100 million users in just two months, shattering previous records on speed of adoption), equity investors have been very excited indeed about the prospects for AI while simultaneously trying to identify the losers on the wrong end of this technological change.

A strong consensus has developed around the likely winners: a narrow list of already successful mega cap technology companies. These stocks have risen dramatically this year and account for virtually all the net returns of the S&P 500. We observe much less of a consensus around the likely losers.

What do our investors think? First, and most importantly, we believe this trend is still very much in its infancy and there is a tremendous amount that we (and everyone else) cannot know yet. For example, following Nvidia’s stunning first quarter earnings news and guidance, we significantly increased our profit forecasts for the company. We are sticking with the obvious winners but keeping an open mind—“high conviction, loosely held,” to quote one of our growth portfolio managers.

Second, while the perceived winners are now highly priced, they have far greater revenues and are much more profitable than were the leaders in previous periods of euphoria, even though valuations and the level of price momentum look similar. Therefore, we are staying invested but alert to new developments as the AI transformation moves forward at lightning speed.

Japanese stocks: Back in vogue after languishing for 30 years

While Chinese equities have been a clear disappointment for investors this year, another Asian equity market has been in fine form: Japanese stocks have gained 20% year to date and now rival even the mighty S&P 500’s returns over the last three years. Longer term, the picture looks very different. Remarkably, the Japanese stock market has yet to recover to the levels reached at the peak of the 1980s real estate bubble, while the U.S. market has gained over 1,200% during this same period.

Expectations of corporate reform and a less conservative approach to balance sheet management and shareholder returns have revived enthusiasm for Japanese stocks. Authorities at the Tokyo Stock Exchange have been driving change, threatening to de-list companies that are unable to persuade their shareholders to lift their valuations to at least book value. This action could add significant value to a market where 50% of listed companies currently trade at discounts to book. While this statistic is somewhat misleading, as the exchange includes a long tail of illiquid small companies, even in the large cap MSCI Japan universe nearly 20% of stocks meet that unfortunate standard.

Following recent gains, our research tells us that the market is no longer a bargain, unless restructuring
Build stronger equity portfolios with J.P. Morgan

Our equity expertise is founded on deep resources across regions and sectors, and a commitment to nurture the brightest talent. Delivering consistent results is at the heart of everything we do.

**Outcome-oriented active management:**

- Benefit from the local market expertise and deep resources of our globally integrated team of experienced equity investment professionals.
- Gain a broader view on equity markets with our timely macro and market views, and be guided by our proprietary portfolio insights and equity analytic tools.
- Invest across a broad range of actively managed equity strategies, covering multiple investment styles and geographies.
- Partner with one of the world’s leading equity managers and benefit from our long history of innovation and success.

---

Exhibit 3 shows the views of our team members. Overall, they remain cautious, prefer quality and think it is too early to take a strong stance against the AI winners.

**Views from our Global Equity Investors Quarterly, June 2023**

![Exhibit 3](image)

Source: A subset of results is shown from a June 2023 survey of Global Equity Investors Quarterly participants. These responses are taken from a quarterly survey representing 30 CIOs and portfolio managers across global equities.